



# 2003 Annual Report

A division of the South Dakota Department of Revenue and Regulation

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# Lottery Personnel

## **MAIN OFFICE**

**P. O. Box 7107  
207 E. Capitol, Suite 200  
Pierre, SD 57501  
605-773-5770  
FAX: 605-776-5786**

Clint Harris, Executive Director  
Mary Jo Bibby  
Joanne Brandlee (Aberdeen)  
Nancy Bugay  
Dennis Doerr  
Shirleen Fugitt  
Karm Gilbert  
John Hepper  
Roxie Hornak  
Patty Kirby  
Sherry Lauseng  
Ron Leidholt  
Peggy Moller  
Mike Mueller  
Julie Pirnat-Schultz  
Mary Schnabel  
Linda Titze  
Rich Ward  
Jennie Weingart  
Joe Willingham

## **LOCAL OFFICE**

**3824 S. Western Avenue  
Sioux Falls, SD 57105  
605-367-5840**

Dick Barrett  
Doug David  
Ron McKinley  
Lana Okeson  
Dan Sahr  
Ann Utech

## **LOCAL OFFICE**

**107 B New York Street  
Rapid City, SD 57701  
605-394-5106**

Cindy Delzer  
Karen Reber  
Sandra Schleining  
Starla Volk

# South Dakota Lottery Commission

Mike Braley, Chairman  
Dennis Wagner  
Nancy Gunner  
Lance Russell

Duane Schmautz  
Tom Leckey  
Susan Shay Brugger

# About the Lottery



Clint Harris, Executive Director

The South Dakota Lottery markets instant tickets and lotto games, and regulates video lottery to raise revenue for state programs and projects. In the 16 years the Lottery has been in operation, more than \$1 billion in revenue has been distributed.

The Lottery operates under the oversight of the seven-member South Dakota Lottery Commission, which meets quarterly to establish policy within the legal framework set by the legislature. The Commission also reviews and approves major contracts and procurements, and consults on management and operation of all aspects of the Lottery. The Lottery has 33 employees; its central office is in Pierre with regional sales and redemption offices in Sioux Falls and Rapid City and a sales representative's office in Aberdeen. Clint Harris was appointed executive director by Governor Rounds in April, 2003.

## Sales and Revenue

Total FY2003 Lottery revenue distributed to state funds was more than \$112 million, a 2.5 percent increase over FY2002 and a record amount of revenue distributed by the Lottery.

### FY2003 Lottery Sales and Revenues

	Sales	Prizes	Retailer Commissions	Revenue Distributed
Instant Tickets	\$13,278,754	\$8,055,990	\$744,812	\$3,076,834
Lotto Tickets	15,360,128	7,788,318	875,140	3,666,489
Video Lottery*	618,254,711	406,000,048	106,127,331	105,313,657
<b>Total:</b>				<b>\$112,056,980</b>

\*Video lottery sales are cash in; prizes are cash out; private share of net machine income is retailer commission.

## Instant Tickets

The Lottery launched 16 new instant ticket games during FY2003. Prices for instant tickets range from \$1 to \$10, with prizes ranging from \$1 to \$150,000 and merchandise prizes. At the close of the fiscal year, there were 578 licensed instant ticket retailers across the state. Retailers receive a 5 percent commission for selling tickets, and a 1 percent commission for cashing winning tickets with prizes up to \$100 and 1 percent for selling winning tickets with prizes of more than \$100. Sales of instant tickets were up 7.7 percent in FY2003 as compared to FY2002. The increase in sales is attributed to successful design of popular games and the strong sales of holiday-themed tickets during the holiday season. Revenue from the sale of instant tickets is distributed to the General Fund.

## Lotto Tickets

South Dakota currently offers four lotto games; three are multi-state games (Powerball, Wild Card 2, and Hot Lotto) and one is exclusive to South Dakota (Dakota Cash). At the end of FY2003, there were 341 licensed lotto retailers. Lotto retailers also receive a 5 percent commission for selling tickets, plus varying bonuses for selling larger winning tickets.

Sale of lotto tickets were up 10.2 percent in FY2003 from the previous fiscal year, due primarily to two large Powerball jackpot runs during the fiscal year and steadily increasing sales of Dakota Cash, Wild Card 2, and Hot Lotto. The first \$1.4 million of revenue from the sale of lotto tickets is distributed to the General Fund, and the balance is distributed to the Capital Construction Fund.

## Video Lottery

The Lottery regulates and controls the video lottery game activities through licensing procedures for the machines, machine owners and operators, and establishments, as well as a comprehensive secure central computer system. Video lottery sales (cash in) increased 2.4 percent in FY2003. The average number of active video lottery machines during FY2003 was 8,247 with the average number of licensed establishments at 1,415.

The revenue from video lottery is calculated on Net Machine Income, which is cash-in (sales) minus cash-out (prizes). Net machine income is divided between the state and machine operators on a 50/50 split. One-half of one percent (0.5%) of state's share is retained by the Lottery for administration. Revenue from video lottery is distributed to the Property Tax Reduction Fund. A portion of machine manufacturer license fees is distributed to the General Fund.

### FY2003 Lottery Revenue Distribution

	General Fund	Capital Construction Fund	Property Tax Reduction Fund	Dept. of Human Services*
Instant Tickets	\$3,076,834			
Lotto Tickets	1,400,000	2,266,489		
Video Lottery	60,000		105,066,058	187,599
<b>Totals</b>	<b>\$4,536,834</b>	<b>\$2,266,489</b>	<b>\$105,066,058</b>	<b>\$187,599</b>

\*The Lottery annually provides the SD Dept. of Human Services up to \$200,000 for problem gambling treatment services. Funding comes from the Lottery's 0.5 percent of net machine income for administration.

# The Year in Review

The South Dakota Lottery enjoyed another successful year in FY2003. Sales and revenue to the state were up for all three products: lotto, instant and video lottery. Here's a look at some of the events that helped contribute to the achievement.

During the month of July, a "Crazy Days" promotion doubled the prizes of \$100 or more on three \$1 scratch games. The promotion boosted sales by more than 6 percent and thrilled dozens of players who discovered their tickets were worth twice the scratched off prize amount.

September marked the Lottery's 15th anniversary. A beautiful \$5 scratch ticket, 15 Grand Years, commemorated the event. The ticket featured the largest top prize ever offered by the South Dakota Lottery -- \$15,000 a year for ten years, a total prize of \$150,000.

The Powerball game was revamped in October. The change was designed to produce higher jackpots and introduced a Match 5 Bonus feature. The Match 5 Bonus kicks in when Powerball jackpots reach record levels. The jackpot increases by a set \$25 million and the pool excess is divided equally among all winners of the Match 5 prize. The new game also dropped the use of "1" as one of the Power Play numbers. Players taking the Power Play option can now be assured their prizes will be multiplied from two to five times.



Wayne Lemme of Madison hit the \$856,000 Wild Card jackpot.

A fun promotion was launched in December. Players purchasing five Dakota Cash tickets received a free Power Play ticket. The promotion increased Dakota Cash sales by 55 percent and helped educate players about the Power Play option. Madison police chief Wayne Lemme had an exceptionally fortunate December, winning the \$856,000 Wild Card jackpot. Lemme's win represented the state's largest Wild Card prize to date.

The Lottery rang in the new year with another doubler promotion in January. This time prizes of \$100 or more with four selected instant games were doubled. Player interest ran high and instant sales were up 8.2 percent.

Lottery history was made on February 1st when a 34-member group of lucky co-workers from the Watertown area nabbed the state's first and long-awaited Powerball jackpot. The group split the \$101.8 million jackpot with an Indiana player, taking the \$27.4 million cash option for their half of the jackpot. After taxes, each member received \$558,507. Just two weeks later, Barb Morrison claimed the first 15 Grand Years top prize of \$150,000. The exciting month was capped off when Jill and Wayne Rand of Sioux Falls claimed the year's largest Dakota Cash prize of \$261,232.



The "Watertown 34" hit South Dakota's first Powerball jackpot.

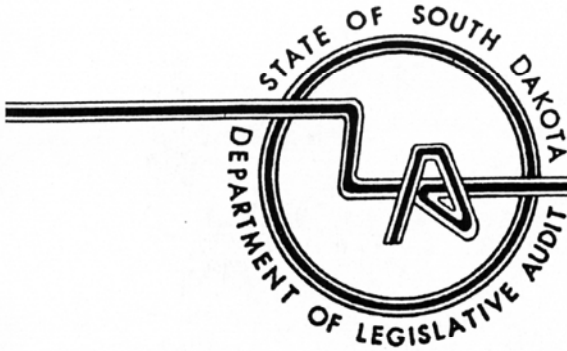
In March, Governor Rounds appointed four new members to the South Dakota Lottery Commission. The new appointees are Susan Shay Brugger, Pierre; Lance Russell, Hot Springs; Duane Schmautz, Pierre; and Tom Leckey, Pierre.



Arlene Carter-Snyder, center, left her \$73,000 Dakota Cash ticket at a store, but an honest clerk and manager saw that it was rightfully returned.

An executive order by the Governor in April reorganized several state agencies. The Lottery became a part of the newly formed Department of Revenue and Regulation. The new agency combines existing revenue functions with the Lottery and the banking, securities, insurance and gaming commissions.

An interesting winner story also occurred in April. A Piedmont player had several lotto tickets checked at her local convenience store. After she left, the clerk discovered the player had left a ticket that had not yet been checked. That ticket was a \$73,000 Dakota Cash jackpot winner. The store owner contacted the Lottery and a search was launched to find the player. After returning from vacation two weeks later, Arlene Carter-Snyder was greeted with the news and was identified as the winner.



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MARTIN L. GUINDON, CPA  
AUDITOR GENERAL

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Honorable M. Michael Rounds  
Governor of South Dakota

and

South Dakota Lottery Commission  
State of South Dakota

We have audited the financial statements of the South Dakota Lottery, an enterprise fund of the State of South Dakota, as of and for the fiscal year ended June 30, 2003, and have issued our report thereon dated December 10, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the South Dakota Lottery's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

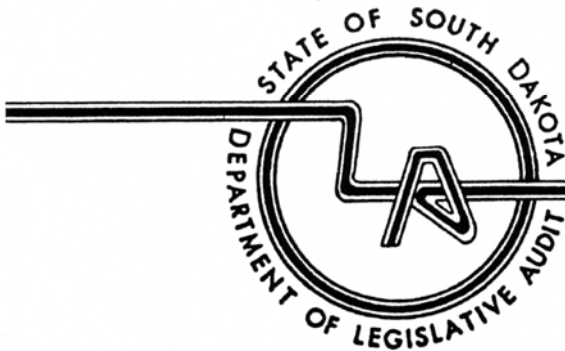
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the South Dakota Lottery's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management and the South Dakota Legislature and is not intended to be and should not be used by anyone other than those specified. However, this report is a matter of public record and its distribution is not limited.

Martin L. Guindon, CPA  
Auditor General

December 10, 2003



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MARTIN L. GUINDON, CPA  
AUDITOR GENERAL

## INDEPENDENT AUDITOR'S REPORT

The Honorable M. Michael Rounds  
Governor of South Dakota

and

South Dakota Lottery Commission  
State of South Dakota

We have audited the accompanying financial statements of the South Dakota Lottery, an enterprise fund of the State of South Dakota, as of and for the fiscal year ended June 30, 2003, as listed in the Table of Contents. These financial statements are the responsibility of the South Dakota Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements present only the South Dakota Lottery and do not purport to, and do not, present fairly the financial position of the State of South Dakota as of June 30, 2003, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the South Dakota Lottery as of June 30, 2003, and the results of its operations and cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2003, on our consideration of the Lottery's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and, in considering the results of the audit, this report should be read along with the independent auditor's report on the financial statements.

Martin L. Guindon, CPA  
Auditor General

December 10, 2003

**SOUTH DAKOTA LOTTERY**  
**STATEMENT OF NET ASSETS**  
*June 30, 2003 and 2002*

<b>Assets</b>	<b>2003</b>	<b>2002</b>
Current Assets:		
Cash and Cash Equivalents	\$7,031,288	\$5,971,007
Accounts Receivable (Net)	5,046,738	4,525,124
Interest Receivable	68,783	92,678
Certificates of Deposit	777,448	657,003
Securities Lending Collateral	2,209,692	1,282,258
Prepays	9,609	11,216
Total Current Assets	15,143,558	12,539,286
Noncurrent Assets:		
Capital Assets less Accumulated Depreciation	10,141	11,860
<b>Total Assets</b>	<b>\$15,153,699</b>	<b>\$12,551,146</b>
<b>Liabilities</b>		
Current Liabilities:		
Accounts Payable	\$397,190	\$137,592
Prizes Payable	709,511	796,605
Due to the Property Tax Reduction Fund	4,096,330	3,920,829
Due to the Capital Construction Fund	66,489	169,639
Due to the General Fund	576,834	44,199
Due to Other Funds	85,798	86,589
Operator Security Deposits	844,548	662,903
Escrows Payable-Reservation Sales	50,019	27,350
Accrued Liabilities	195,488	169,798
Deferred Revenue	198,319	96,617
Securities Lending Collateral Liability	2,209,692	1,282,258
Total Current Liabilities	9,430,218	7,394,379
Noncurrent Liabilities:		
Accrued Liabilities	104,664	100,074
<b>Total Liabilities</b>	<b>\$9,534,882</b>	<b>\$7,494,453</b>
<b>Net Assets</b>		
Invested in Capital Assets, net of Related Debt	\$10,141	\$11,860
Unrestricted	5,608,676	5,044,833
<b>Total Net Assets</b>	<b>\$5,618,817</b>	<b>\$5,056,693</b>

The accompanying notes are an integral part of the financial statements.



**SOUTH DAKOTA LOTTERY**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS**  
*For the Fiscal Years Ended June 30, 2003 and 2002*

	2003	2002
<b>Operating Revenues:</b>		
Video Lottery Revenue	\$106,127,331	\$103,865,443
Instant Ticket Sales	13,278,754	12,334,288
On-Line Ticket Sales	15,360,128	13,944,151
Terminal License Fees	911,800	902,800
Retailer License Fees	284,500	247,575
<b>Total Operating Revenue</b>	<b>135,962,513</b>	<b>131,294,257</b>
<b>Direct Game Costs:</b>		
Instant Prizes	8,055,990	7,257,636
On-Line Prizes	7,788,318	6,886,042
Instant Retail Commissions	744,812	685,894
On-Line Retail Commissions	875,140	766,431
Instant Ticket Print Costs	259,865	532,776
<b>Total Direct Costs</b>	<b>17,724,125</b>	<b>16,128,779</b>
<b>Gross Profit</b>	<b>118,238,388</b>	<b>115,165,478</b>
<b>Operating Expenses:</b>		
Personal Services and Benefits	1,286,014	1,210,160
Travel	141,847	131,244
Advertising	628,999	578,102
Contractual Services	3,922,133	3,699,655
Supplies and Materials	89,528	147,027
Depreciation	1,719	1,854
<b>Total Operating Expenses</b>	<b>6,070,240</b>	<b>5,768,042</b>
<b>Operating Income</b>	<b>112,168,148</b>	<b>109,397,436</b>
<b>Nonoperating Revenues (Expenses):</b>		
Pooled Investment Income	503,441	573,911
Broker Rebate Expense	(28,378)	(54,753)
Payments to Reservations	(50,019)	(29,951)
Non-Compliance Fees	1,000	20,000
Miscellaneous Revenue	24,912	9,465
<b>Total Nonoperating Revenue (Expenses)</b>	<b>450,956</b>	<b>518,672</b>
<b>Income Before Transfers</b>	<b>112,619,104</b>	<b>109,916,108</b>
<b>Transfers:</b>		
Transfers to the Property Tax Reduction Fund	105,066,058	102,826,789
Transfers to the General Fund	4,536,834	4,274,199
Transfers to the Capital Construction Fund	2,266,489	1,969,639
Transfers to the Department of Human Services	187,599	200,000
<b>Total Transfers</b>	<b>112,056,980</b>	<b>109,270,627</b>
<b>Change in Net Assets</b>	<b>562,124</b>	<b>645,481</b>
Total Net Assets - Beginning	5,056,693	4,411,212
<b>Total Net Assets - Ending</b>	<b>\$5,618,817</b>	<b>\$5,056,693</b>

The accompanying notes are an integral part of the financial statements.

**SOUTH DAKOTA LOTTERY**  
**STATEMENT OF CASH FLOWS**  
*For the Fiscal Year Ended June 30, 2003 and 2002*

	2003	2002
<b>Cash Flows from Operating Activities</b>		
Receipts from Customers and Users	\$135,469,562	\$131,299,284
Payments for Lottery Prizes	(15,873,254)	(14,012,604)
Payments to Suppliers	(5,524,461)	(5,787,080)
Payments for Interfund Services Used	(853,895)	(819,320)
Payments for Employee Services	(1,264,234)	(1,177,580)
Other Receipts (Payments)	59,599	5,222
Net Cash Provided (Used) by Operating Activities	<u>112,013,317</u>	<u>109,507,922</u>
<b>Cash Flows from Noncapital Financing Activities</b>		
Transfers to Other Funds	(111,451,994)	(109,594,187)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(111,451,994)</u>	<u>(109,594,187)</u>
<b>Cash Flows from Investing Activities</b>		
Pooled Investment Income	527,336	585,615
Security Lending Rebate Fees	(28,378)	(54,753)
Net Cash Provided (Used) by Investing Activities	<u>498,958</u>	<u>530,862</u>
Net Increase (Decrease) in Cash and Cash Equivalents During the Fiscal Year	1,060,281	444,597
Cash and Cash Equivalents at Beginning of Year	5,971,007	5,526,410
Cash and Cash Equivalents at End of Year	<u><u>\$7,031,288</u></u>	<u><u>\$5,971,007</u></u>
<b>Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities</b>		
Operating Income	\$112,168,148	\$109,397,436
<b>Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:</b>		
Depreciation Expense	1,719	1,854
Other Revenue	25,912	29,465
<b>Increase/Decrease in Assets:</b>		
Increase/Decrease in Accounts Receivable	(520,664)	15,958
Increase/Decrease in Certificates of Deposit	(120,445)	300
Increase/Decrease in Prepaids	1,607	(400)
<b>Increase/Decrease in Liabilities:</b>		
Increase/Decrease in Accounts Payable	259,598	(16,080)
Increase/Decrease in Prizes Payable	(87,094)	107,598
Increase/Decrease in Due to Other Funds	(791)	(39,131)
Increase/Decrease in Operator Security Deposits	181,645	3,700
Increase/Decrease in Escrows Payable	22,669	1,965
Increase/Decrease in Accrued Liabilities	30,280	27,080
Increase/Decrease in Deferred Revenue	101,702	7,178
Payments Made to Reservations	(50,019)	(29,951)
Bad Debts	(950)	950
Total Adjustments	<u>(154,831)</u>	<u>110,486</u>
Net Cash Provided by Operating Activities	<u><u>\$112,013,317</u></u>	<u><u>\$109,507,922</u></u>

The notes to the financial statements are an integral part of this statement.

**SOUTH DAKOTA LOTTERY**  
**STATEMENT OF CASH FLOWS**  
*For the Fiscal Year Ended June 30, 2003 and 2002*

	2003	2002
<b>Cash Flows from Operating Activities</b>		
Receipts from Customers and Users	\$135,469,562	\$131,299,284
Payments for Lottery Prizes	(15,873,254)	(14,012,604)
Payments to Suppliers	(5,524,461)	(5,787,080)
Payments for Interfund Services Used	(853,895)	(819,320)
Payments for Employee Services	(1,264,234)	(1,177,580)
Other Receipts (Payments)	59,599	5,222
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Net Cash Provided (Used) by Investing Activities	<u>498,958</u>	<u>530,862</u>
Net Increase (Decrease) in Cash and Cash Equivalents During the Fiscal Year	1,060,281	444,597
Cash and Cash Equivalents at Beginning of Year	5,971,007	5,526,410
Cash and Cash Equivalents at End of Year	<u><u>\$7,031,288</u></u>	<u><u>\$5,971,007</u></u>
<b>Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities</b>		
Operating Income	\$112,168,148	\$109,397,436
<b>Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided by Operating Activities:</b>		
Depreciation Expense	1,719	1,854
Other Revenue	25,912	29,465
<b>Increase/Decrease in Assets:</b>		
Increase/Decrease in Accounts Receivable	(520,664)	15,958
Increase/Decrease in Certificates of Deposit	(120,445)	300
Increase/Decrease in Prepaids	1,607	(400)
<b>Increase/Decrease in Liabilities:</b>		
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Increase/Decrease in Due to Other Funds	(791)	(39,131)
Increase/Decrease in Operator Security Deposits	181,645	3,700
Increase/Decrease in Escrows Payable	22,669	1,965
Increase/Decrease in Accrued Liabilities	30,280	27,080
Increase/Decrease in Deferred Revenue	101,702	7,178
Payments Made to Reservations	(50,019)	(29,951)
Bad Debts	(950)	950
Total Adjustments	<u>(154,831)</u>	<u>110,486</u>
Net Cash Provided by Operating Activities	<u><u>\$112,013,317</u></u>	<u><u>\$109,507,922</u></u>

The notes to the financial statements are an integral part of this statement.

**SOUTH DAKOTA LOTTERY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
***For the Fiscal Years Ended June 30, 2003 and 2002***

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization** The South Dakota Lottery Fund was created by the passage of Senate Bill 0254 during the 1987 Legislative Session. The South Dakota Lottery was authorized to market instant win games, with sales commencing on September 30, 1987.

Video Lottery was created by the passage of Senate Bill 0129 during the 1989 Legislative Session. The South Dakota Lottery was authorized to license and regulate a video lottery game with play commencing on October 16, 1989.

The 1990 Legislature approved lotto games with the passage of Senate Bill 0086. In April of 1990, South Dakota was accepted as a member of the Multi-State Lottery Association (MUSL) and on November 15, 1990, South Dakota began selling MUSL's Lotto\*America game. Powerball replaced Lotto\*America on April 19, 1992. Powerball was a 5 of 45 plus 1 of 45 game, with drawings twice a week. On November 5, 1997, Powerball changed to a 5 of 49 plus 1 of 42 game. The Power Play multiplier became available on March 3, 2001, and is an option to each Powerball play. A multiplier of 1, 2, 3, 4 or 5 was randomly selected during each drawing and would multiply the Powerball set prize amounts (except the jackpot) for players who purchased the option and won a set prize. On October 6, 2002, the Powerball matrix changed to 5 of 53 and 1 of 42. The Power Play multiplier also changed to one of 2, 3, 4 or 5.

Sales of Dakota Cash, South Dakota's own lotto game, with a minimum jackpot of \$20,000, began on April 12, 1993. Dakota Cash is a 5 of 35 lotto game with drawings twice a week. The prize pool is 50 percent of each drawing period's sales. Two percent is put in a prize reserve fund until a cap of \$200,000 is reached. At June 30, 2003 and 2002, the prize reserve fund had a balance of \$200,000 and \$199,868, respectively.

The South Dakota Lottery joined with the Montana and Idaho lotteries to offer Tri-West Lotto on February 21, 1994. Tri-West Lotto was a 6 of 41 lotto game with a prize pool of 50 percent of sales. After February 4, 1995, the game became a 6 of 33 lotto game with a prize pool of 55 percent of sales. Tri-West Lotto was replaced by Wild Card on February 1, 1998. Wild Card was a 6 of 38 plus a 1 of 52 lotto game and also had a prize pool of 55 percent of sales. On May 22, 1999, Wild Card was replaced by Wild Card 2, a 5 of 31 plus a 1 of 16 lotto game with a prize pool of 55 percent of sales. Wild Card 2 drawings are held twice a week.

The South Dakota Lottery began selling MUSL's Daily Millions game on September 16, 1996. Daily Millions was an all-cash lotto game played 7 days a week with a fixed top prize of \$1 million. To play Daily Millions, 2 numbers were drawn from 3 separate pools of 21 each. Daily Millions ended and Cash 4 Life began on March 30, 1998. The Cash 4 Life game allowed 15 sets of 4 numbers between 00 and 99 and was played 7 days a week. On September 8, 2000, Cash 4 Life was replaced by Rolldown, a 5 of 55 lotto game. Drawings were held 3 days a week. If there was no jackpot prize winner, the jackpot rolled down to all other prize levels. On April 7, 2002, Rolldown was replaced by Hot Lotto, a 5 of 39 plus 1 of 19 lotto game with drawings held 2 times a week.

The purpose of the Lottery is to provide additional monies to fund vital public projects and programs.

**Basis of Presentation** The South Dakota Lottery Fund is accounted for as a proprietary type enterprise fund for the State of South Dakota. Proprietary funds are accounted for using the accrual basis of accounting. The proprietary funds apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. Revenues are recognized when they are earned, and expenses are recognized when they are incurred. The financial statements are prepared in accordance with generally accepted accounting principles for proprietary (enterprise) funds.

**Cash, Cash Equivalents, and Investments** Funds of the South Dakota Lottery are on deposit with the South Dakota State Treasurer who preserves the integrity of the fund cash balance of each state fund while simultaneously allowing the deposit and investment of aggregate idle fund moneys. Investing is controlled by the South Dakota Investment Council. Interest is prorated once a year to participating funds and is

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recognized when earned. At June 30 these deposits were fully insured or collateralized with securities held by the state or its agent in the state's name.

Cash, cash equivalents, and investments are reported at fair value in accordance with GASB Statement No. 31. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

**Operator Security Deposits** ARSD 48:02:05:04(18) requires video lottery operators to furnish security to the lottery by July 1 of each year equal to one-eighteenth of the state's share of estimated annual net machine income derived from the operator's video lottery machines. Security may be in the form of a surety bond, deposit in cash, an irrevocable letter of credit, or a certificate of deposit issued by a South Dakota financial institution with the Lottery endorsed on it as a payee. As of June 30, 2003 and 2002, the amount of certificates of deposit being held by the Lottery was \$777,448 and \$657,003, respectively. The amount of \$5,542,100 and \$5,114,900, respectively, was in the form of surety bond, deposit in cash, or irrevocable letter of credit. The total Security Deposits on June 30, 2003 and 2002, were \$6,319,548 and \$5,771,903, respectively.

**Accounts Receivable** Accounts receivable (net) represents the following:

	<u>2003</u>	<u>2002</u>
<i>Uncollected instant/on-line ticket revenues</i>	\$ 911,736	\$ 582,340
<i>Allowance for doubtful instant/on-line accounts</i>	(18,689)	(19,639)
<i>Uncollected video lottery revenues and fees</i>	4,153,691	3,962,423
	<u>\$5,046,738</u>	<u>\$4,525,124</u>

**Furniture, Fixtures & Equipment** Furniture, fixtures and equipment are carried at cost or estimated historical cost if the original cost is unavailable. Fixed assets are capitalized, based on the criteria of: a useful life of one year or more; tangible in nature; and a unit cost of \$5,000 or more. Depreciation is computed using the straight-line method over the asset's estimated useful life. When assets are disposed of, the costs and related accumulated depreciation are removed from the accounts. Any gain or loss is reflected in operations in the period of disposal.

**Due to the General Fund and Due to the Capital Construction Fund** The Lottery shall maximize net proceeds to the state from the sale of instant and on-line tickets. These net proceeds are transferred to the General Fund/Capital Construction Fund on an annual basis on or about July 1. There was a liability for instant ticket sales to the General Fund in the amount of \$576,834 and \$44,199 and a liability for on-line ticket sales to the Capital Construction Fund in the amount of \$66,489 and \$169,639 as of June 30, 2003 and 2002, respectively.

**Due to the Property Tax Reduction Fund** SDCL 42-7A-63 sets the state's percentage of net machine income at fifty percent (50%) of which all but one-half of one percent (0.5%) of net machine income shall be deposited into the Property Tax Reduction Fund. At June 30, 2003 and 2002, there was a liability to the Property Tax Reduction Fund in the amount of \$4,096,330 and \$3,920,829, respectively.

**Deferred Revenue** A liability has been recorded for on-line tickets sold for future drawings that were collected before June 30.

**Accrued Liabilities** Accrued liabilities that have been incurred but not yet paid as of June 30 include accrued wages, accrued bonuses and accrued benefits.

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**Revenue Recognition** Sales of instant and on-line tickets are made to the public through licensed retailers. Instant ticket sales for games in progress are recorded as retailers settle (sell) the books of tickets. Adjustments based upon the known relationship of the number of tickets sold to the number of winning tickets redeemed through the end of the accounting period are made as necessary. Instant ticket sales for ended games and on-line ticket sales are reported as the actual ticket sales made to the public through the licensed retailers.

**Prizes** Prize expense for instant games is recorded as prizes are paid. Adjustments are made based on the predetermined prize structure for each instant game as necessary. Prizes payable represents the difference between the amount of prize expense recognized and actual prizes paid.

Prize expense and prizes payable for on-line games are recorded based on actual drawing results. Prizes payable represents unpaid prizes not yet claimed or reverted.

A minimum of fifty percent (50%) of the projected revenue from the sale of lottery tickets, computed on a year-round basis, is allocated for payment of prizes. Prizes may be claimed up to 180 days after the official end of the game. Unclaimed prizes are added to the prize pools of subsequent lottery games. Reverted prizes during the fiscal years ended June 30, 2003 and 2002, were \$517,899 for on-line prizes and \$225,558 for instant prizes, and \$329,702 for on-line prizes and \$235,076 for instant prizes, respectively.

**Escrows Payable** During the 1989 Legislative Session, HB 1344 passed which authorizes tribal governments to receive up to fifty percent (50%) of the state's revenue on lottery products sold on that reservation. Fifty percent (50%) of the state's share of revenue on the reservations has been escrowed for payment to them.

**Due to Other Funds** A liability has been created for services provided by other components of state government but not yet paid as of June 30.

**Retailer Commission** Lottery retailers selling instant and on-line tickets receive a five percent (5%) commission on each ticket sold or distributed to the public. Instant retailers receive a one percent (1%) selling commission for selling instant prize winning tickets over \$101 and a one percent (1%) cashing commission for cashing instant prize winning tickets of \$1 up to \$100.

On-line retailers selling a jackpot winning Powerball ticket may receive a bonus of \$30,000. Selling bonuses of \$5,000 and \$500 may be paid to retailers selling Powerball tickets of \$100,000 and \$5,000, respectively. Retailers who sell a Dakota Cash jackpot winning ticket may receive a bonus equal to five percent (5%) of the value of the winning ticket not to exceed \$5,000. Retailers who sell a Wild Card 2 jackpot winning ticket may receive a bonus equal to one percent (1%) of the value of the winning ticket, not to exceed \$10,000. Retailers who sell a Hot Lotto jackpot winning ticket or a \$10,000 winning ticket may receive a bonus of \$10,000 and \$1,000, respectively.

**NOTE 2. CASH, CASH EQUIVALENTS, AND INVESTMENTS HELD BY SOUTH DAKOTA INVESTMENT COUNCIL**

Cost and fair value of cash, cash equivalents, and investments on June 30 consist of the following:

	<u>2003</u> <u>Cost</u>	<u>2003</u> <u>Fair Value</u>	<u>2002</u> <u>Cost</u>	<u>2002</u> <u>Fair Value</u>
<i>Cash, Cash Equivalents, and Investments managed by the South Dakota Investment Council</i>	\$6,810,665	\$7,022,171	\$5,833,358	\$5,967,325
<i>Cash in Local Bank Accounts</i>	<u>\$9,117</u>	<u>\$9,117</u>	<u>\$3,682</u>	<u>\$3,682</u>

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Total	<u>\$6,819,782</u>	<u>\$7,031,288</u>	<u>\$5,837,040</u>	<u>\$5,971,007</u>
Securities Lending Transactions				

State statutes and the South Dakota Investment Council (SDIC) policies permit the use of investments for securities lending transactions. These transactions involve the lending of securities to broker-dealers and other entities for collateral, in the form of cash or securities with the simultaneous agreement to return the collateral for the same securities in the future. The cash collateral is reinvested by the lending agent in accordance with contractual investment guidelines that are designed to ensure the safety of principal and obtain a moderate rate of return. The investment guidelines include very high credit quality standards and also allow for a portion of the collateral investments to be invested with short-term securities. The earnings generated from the collateral investments, less the amount of rebates paid to the dealers, results in gross earnings from lending activities, which is then split on a percentage basis with the lending agent.

At year end, no credit risk exposure to borrowers existed because the amounts owed the borrowers exceeded the amounts the borrowers owed. The contract with the lending agent requires them to indemnify if the borrowers fail to return the loaned securities (and the collateral is inadequate to replace the securities lent).

The securities loans can be terminated on demand by either the SDIC or the borrower, although the average term of the loans is one business day. The term to maturity of the securities loans is matched with the term to maturity of the investments of the cash collateral by investing in a variety of short-term investments.

The ability to pledge or sell collateral securities can be made without borrower default. In addition, no restriction on the amount of the loans exist or can be made. The amount reported as Securities Lending Collateral of \$2,209,692 and \$1,282,258 and Securities Lending Collateral Liability of \$2,209,692 and \$1,282,258 on the statement of net assets represents the Lottery's share of the SDIC total as of June 30, 2003 and 2002, respectively.

**NOTE 3. ANNUAL AND SICK LEAVE**

Annual leave is earned by all employees. Upon termination, employees are eligible to receive compensation for their accrued annual leave balances. At June 30, 2003 and 2002, a liability existed for accumulated annual leave calculated at the employee's June 30 pay rate in the amount of \$96,563 and \$97,790, respectively. Employees who have been continuously employed by the State of South Dakota for at least seven years prior to the date of their retirement, voluntary resignation or death will receive payment for one-fourth of their accumulated sick leave balance, such payment not to exceed the sum of twelve weeks of employee's annual compensation. At June 30, 2003 and 2002, a liability existed for accumulated sick leave for twenty-three (23) employees calculated at the employee's June 30 pay rate in the amount of \$110,789 and \$93,829, respectively. A potential liability also existed for unvested sick leave at June 30, 2003 and 2002, in the amount of \$8,000 and \$8,111, respectively, of which \$5,728 and \$5,807, respectively, has been accrued.

**NOTE 4. OPERATING LEASES**

The South Dakota Lottery entered into agreements to lease buildings and certain equipment. Some of the operating leases contain the provision that the South Dakota Lottery may renew the operating leases at the expiration date of the lease on a year-to-year basis. In most cases management expects that in the normal course of business, leases will be renewed or replaced by other leases of a similar nature.

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The following schedule is a summary of future minimum rental payments by years required under operating leases with lease terms in excess of one year as of June 30, 2003:

<u>Period Ending June 30:</u>	
2004	\$ 115,309
2005	79,352
2006	51,339
2007	5,640
2008	3,055
Total Minimum Payments	<u>\$ 254,695</u>

Total rental expense for all operating leases for the fiscal years ended June 30, 2003 and 2002, was \$115,015 and \$134,592, respectively.

**NOTE 5. EMPLOYEES' RETIREMENT SYSTEM**

The South Dakota Retirement System (SDRS) is a cost-sharing, multiple employer public employee retirement system established to provide retirement benefits for employees of the State of South Dakota and its political subdivisions. The SDRS provides retirement, disability and survivor benefits. The right to receive retirement benefits vests after five years of credited service. Authority for establishing, administering and amending plan provisions are found in South Dakota Codified Law 3-12. The SDRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the SDRS, P.O. Box 1098, Pierre, SD 57501-1098 or by calling (605) 773-3731.

Employees are required by state statute to contribute 5 percent of their salary to the plan. State statute also requires the employer to contribute an amount equal to the employee's contribution. The South Dakota Lottery's contributions to the SDRS for the fiscal years ended June 30, 2003, 2002, and 2001 were \$59,290, \$47,024, and \$45,732, respectively, equal to the required contributions each year.

**NOTE 6. VIDEO LOTTERY**

Following is a summary of video lottery revenues for the fiscal years ended June 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Cash In (sales)	\$ 618,254,711	\$ 603,597,346
Less Cash Out (prizes)	406,000,048	395,866,460
Video Lottery Net Machine Income	<u>212,254,663</u>	<u>207,730,886</u>
Less Operator and Establishment Share	106,127,331	103,865,443
Video Lottery Revenue Available to the State	<u>106,127,331</u>	<u>103,865,443</u>
Less Lottery Operating Share	1,061,273	1,038,654
Video Lottery Revenue to the Property Tax Reduction Fund	<u>\$ 105,066,058</u>	<u>\$ 102,826,789</u>



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**NOTE 7. TRANSFERS**

Following is a summary of total transfers for the fiscal years ended June 30, 2003 and 2002:

Transfers Out:	<u>2003</u>	<u>2002</u>
General Fund Proceeds from Instant and On-Line	\$ 3,900,000	\$ 4,200,000
Capital Construction Fund Proceeds from On-Line	2,200,000	1,800,000
General Fund Proceeds from Instant and On-line not Yet Transferred	576,834	44,199
Capital Construction Fund Proceeds from On-Line not Yet Transferred	66,489	169,639
Video Lottery Proceeds Transferred to the Property Tax Reduction Fund	100,969,728	98,905,960
Video Lottery Proceeds to Prop. Tax Reduction Fund not Yet Transferred	4,096,330	3,920,829
Video Lottery Grant to Department of Human Services	187,599	200,000
Video Lottery Fees Transferred to the General Fund	60,000	30,000
Total Transfers Out	<u>\$112,056,980</u>	<u>\$109,270,627</u>

**NOTE 8. PARTICIPATION IN THE MULTI-STATE LOTTERY**

The South Dakota Lottery is a member of the Multi-State Lottery (MUSL), which operates the Powerball/Power Play, Hot Lotto, and Wild Card 2 games. Each MUSL member sells tickets through its licensed retailers and makes weekly wire transfers to the MUSL in an amount equivalent to the member lottery's share of the prize liability less the actual low-tier prize liability.

The prize pool for Powerball and Hot Lotto consists of 50 percent of each drawing period's sales. The prize pool for Power Play is 48.5 percent of sales. The prize pool for Wild Card 2 is 55 percent of each drawing period sales with all cash prizes. Two percent of sales for Powerball and Wild Card 2 and 1.5 percent for Power Play are placed in a prize reserve fund. For Hot Lotto, up to 1 percent of sales is placed in a prize reserve fund after the annuitized jackpot exceeds \$2 million. An additional 2 percent of sales is placed in a prize reserve fund after the annuitized jackpot exceeds \$5 million. The prize reserve fund serves as a contingency reserve to protect the MUSL in cases of unforeseen liabilities. The money in this reserve is to be used at the discretion of the MUSL Board of Directors.

The prize reserve fund monies may be absorbed by a replacement game or are refundable to member states if MUSL or the MUSL game group disbands or if a member leaves MUSL or a game group. Members leaving must wait one year before receiving their remaining share, if any, of the prize reserve fund. At June 30, 2003 and 2002, the MUSL Powerball prize reserve fund had a balance of \$63,909,373 and \$52,725,253, respectively, of which the South Dakota Lottery's share was \$887,441 and \$600,453, respectively. The set prize reserve fund had a balance of \$24,782,005 and \$25,732,874, respectively, of which the South Dakota Lottery's share was \$157,739 and \$444,728, respectively. The Wild Card 2 prize reserve fund had a balance of \$953,073 and \$956,612, respectively, of which the South Dakota Lottery's share was \$212,233 and \$213,015. At June 30, 2003 and 2002, the Hot Lotto prize reserve fund had a balance of \$0 and \$68,304, respectively, of which the South Dakota Lottery's share was (\$26.35) and \$2,851, respectively. The reserves held by MUSL are not included in these financial statements.

Prior to November 5, 1997, the Powerball jackpot was payable to the winner(s) in annual installments over 20 years, with the first payment being made by the member lottery starting at the time of the drawing. Since November 5, 1997, players can choose one lump-sum cash payment or receive the jackpot prize over 25 annual payments. Treasury zero coupon bonds that provide payments corresponding to the member lottery's obligation to these prize winners are purchased by the MUSL in the name of the member lottery. MUSL will

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hold these bonds and will cash the bonds when due and wire the money to the member lottery's account on or before the anniversary date of the win. The Wild Card 2 jackpot is paid in cash, and will be divided equally among all jackpot winners for a specific drawing. The Hot Lotto jackpot prize can be taken as cash or annuity and is divided equally among multiple winners.

As of June 30, 2003 and 2002, the MUSL had purchased, for the South Dakota Lottery, zero coupon bonds to fund installment payments aggregating \$12,466,937. The total purchase price of these bonds was \$6,509,238.

**NOTE 9. CONTRACTUAL ARRANGEMENTS**

- A. Instant Tickets - The South Dakota Lottery entered into a contract with Scientific Games to provide instant game tickets through June 27, 2005.
- B. On-line and Video Lottery Vendor - The South Dakota Lottery has contracted with IGT Online Entertainment Systems, Inc., a wholly owned subsidiary of International Game Technology, to operate an on-line lottery system and a video lottery system through August 2, 2006, with possible extension through August 2, 2009.